Dated: November 5, 1980, to become effective November 10, 1980.

D. S. Kuryloski,

Deputy Director, Fruit and Vegetable Division, Agricultural Marketing Service.

[FR Doc. 80-34964 Filed 11-5-80; 1:05 pm]

BILLING CODE 3410-02-M

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7 CFR Part 910

[Lemon Reg. 278]

Lemons Grown in California and Arizona; Limitation of Handling

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Final rule.

SUMMARY: This regulation establishes the quantity of fresh California-Arizona lemons that may be shipped to market during the period November 9–15, 1980. Such action is needed to provide for orderly marketing of fresh lemons for this period due to the marketing situation confronting the lemon industry.

EFFECTIVE DATE: November 9, 1980.

FOR FURTHER INFORMATION CONTACT: Malvin E. McGaha, 202–447–5975.

SUPPLEMENTARY INFORMATION: *Findings.* This regulation is issued under the marketing agreement, as amended, and Order No. 910, as amended (7 CFR Part 910), regulating the handling of lemons grown in California and Arizona. The agreement and order are effective under the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601–674). The action is based upon the recommendations and information submitted by the Lemon Administrative Committee, and upon other information. It is hereby found that this action will tend to effectuate the declared policy of the Act.

This action is consistent with the marketing policy for 1980–81 which was designated significant under the procedures of Executive Order 12044. The marketing policy was recommended by the committee following discussion at a public meeting on July 8, 1980. A final impact analysis on the marketing policy is available from Malvin E. McGaha, Chief, Fruit Branch, F&V, AMS, USDA, Washington, D.C. 20250, telephone 202–447–5975.

The committee met again publicly on November 4, 1980, at Los Angeles, California, to consider the current and prospective conditions of supply and demand and recommended a quantity of lemons deemed advisable to be handled during the specified week. The committee reports the demand for lemons is easier.

It is further found that there is insufficient time between the date when information became available upon which this regulation is based and when the action must be taken to warrant a 60 day comment period as recommended in E.O. 12044, and that it is impracticable and contrary to the public interest to give preliminary notice, engage in public rulemaking, and postpone the effective date until 30 days after publication in the **Federal Register** (5 U.S.C. 553). It is necessary to effectuate the declared purposes of the act to make these regulatory provisions effective as specified, and handlers have been apprised of such provisions and the effective time.

Section 910.578 is added as follows:

§ 910.578 Lemon regulation 278.

(a) The quantity of lemons grown in California and Arizona which may be handled during the period November 9, 1980, through November 15, 1980, is established at 215,000 cartons.

(b) As used in this section, "handled" and "carton(s)" mean the same as defined in the marketing order.

(Secs. 1–19, 48 Stat. 31, as amended; 7 U.S.C. 601–674)

Dated: November 5, 1980.

D. S. Kuryloski,

Deputy Director, Fruit and Vegetable Division, Agricultural Marketing Service.

[FR Doc. 80-35055 Filed 11-6-80; 8:45 am]

BILLING CODE 3410-02-M

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7 CFR Part 971

Lettuce Grown in Lower Rio Grande Valley in South Texas; Expenses and Rate of Assessment

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Final rule.

SUMMARY: This regulation authorized expenses for the functioning of the South Texas Lettuce Committee. It will enable the committee to collect assessments from first handlers of lettuce grown in the Lower Rio Grande Valley in South Texas and to use the resulting funds for its expenses.

EFFECTIVE DATE: During fiscal period ending July 31, 1981.

FOR FURTHER INFORMATION CONTACT: Charles W. Porter, Chief, Vegetable Branch, Fruit and Vegetable Division, AMS, U.S. Department of Agriculture, Washington, D.C. 20250 (202) 447–2615. The Impact Analysis relating to this final rule is available upon request from Mr. Porter.

SUPPLEMENTARY INFORMATION: *Findings.* This final action has been reviewed under USDA procedures established in Secretary's Memorandum 1955 to implement Executive Order 12044 and has been classified "not significant."

Pursuant to Marketing Order No. 971 (7 CFR Part 971), regulating the handling of lettuce grown in Cameron, Hidalgo, Starr and Willacy Counties in Texas, effective under the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601–674), and upon the basis of the recommendations and information submitted by the committee, established under the marketing order, and upon other information, it is found that the expenses and rate of assessment, as hereinafter provided, will tend to effectuate the declared policy of the act.

It is further found that it is impracticable and contrary to the public interest to provide 60 days for interested persons to file comments, engage in public rulemaking procedure, and that good cause exists for not postponing the effective date until 30 days after publication (5 U.S.C. 553), as the order requires that the rate of assessment for a particular fiscal period shall apply to all assessable lettuce handled from the beginning of such period. Handlers and other interested persons were given an opportunity to submit information and views on the expenses and assessment rate at an open meeting of the committee on October 21, 1980, at McAllen. No objections were offered. To effectuate the declared purposes of the act, it is necessary to make these provisions effective as specified.

Section 971.219 (44 FR 66178, November 19, 1979) is hereby deleted and a new § 971.220 is added as follows:

§ 971.219 [Deleted]

§ 971.220 Expenses and rate of assessment.

(a) The reasonable expenses that are likely to be incurred during the fiscal period ending July 31, 1981, by the South Texas Lettuce Committee for its maintenance and functioning and for such purposes as the Secretary determines to be appropriate amount to $40,875.

(b) The rate of assessment to be paid by each handler in accordance with this part shall be three cents ($0.03) per carton of assessable lettuce handled by him as the first handler during the fiscal period.

(c) Unexpended income in excess of expenses for the fiscal period may be carried over as a reserve to the extent authorized in § 971.43(a)(2).

(d) Terms used in this section have the same meaning as when used in the marketing agreement and this part.

(Secs. 1–19, 48 Stat. 31, as amended; 7 U.S.C. 601–674).

Dated: November 4, 1980.

D. S. Kuryloski,

Deputy Director, Fruit and Vegetable Division, Agricultural Marketing Service.

[FR Doc. 80-34898 Filed 11-6-80; 8:45 am]

BILLING CODE 3410-02-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, 274

[Release Nos. 33-6254, IC-11414, File No. S7-743]

Bearing of Distribution Expenses by Mutual Funds

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Commission is adopting a rule to permit open-end management investment companies to bear expenses associated with the distribution of their shares, if such companies comply with certain conditions and procedures. The rule requires that any decision by an open-end management investment company to use its assets to finance distribution be approved by its shareholders and directors, including its disinterested directors. The rule also contains provisions intended to ensure that the disinterested directors are not dominated nor unduly influenced by management and that the directors are fully informed and exercise reasonable business judgment. The procedures in the rule by which shareholders and directors would approve a plan to use assets for distribution are generally similar to those prescribed by statute for approval of investment advisory contracts. The procedural requirements are somewhat less stringent than they were in the rule as proposed.

The Commission also is adopting a rule to exempt from the requirement of prior Commission approval, to the extent necessary, certain agreements between open-end management investment companies and their affiliated persons whereby investment company assets are used for distribution, if such agreements are entered into in compliance with the rule permitting such companies to bear their distribution expenses.

The Commission is adopting certain disclosure and reporting requirements relating to the use of assets for distribution, including a revision of the registration and reporting form for open-end management investment companies.

The Commission is taking these actions because it believes that directors and shareholders of open-end management investment companies should be able to make business judgments to use fund assets for distribution in appropriate cases but that, in view of the investment adviser's conflict of interest with respect to any recommendation to bear distribution expenses and because of uncertainties about whether such companies are likely to benefit from such expenditures, any such exercise of business judgment should be subject to conditions designed to ensure that it is made by persons who are free of undue management influence and have carefully considered all relevant factors.

EFFECTIVE DATE: October 28, 1980.

FOR FURTHER INFORMATION CONTACT: Richard W. Grant, Special Counsel to the Director, (202) 272–2041, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is adopting rule 12b–1 (17 CFR 270.12b–1) under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) ("Act") to permit open-end management investment companies ("mutual funds" or "funds") to bear expenses associated with the distribution of their shares. Among the significant provisions of the rule are the following:

—Selection and nomination of directors who are not interested persons of the fund must be committed to the discretion of such disinterested directors;

—A fund which decides to bear distribution expenses must formulate a written plan describing all material aspects of the proposed financing of distribution, and all agreements relating to implementation of the plan must be in writing; such plan and agreements must contain certain provisions similar to those required by the Act for investment advisory contracts;

—The plan must be approved initially: (1) By a vote of at least a majority of the fund's outstanding voting securities; (2) by its board of directors as a whole; and (3) separately by its directors who are not interested persons of the fund and have no direct or indirect financial interest in the operation of the plan or any agreement related to the plan;

—In considering a plan to finance distribution, the directors must give appropriate weight to all pertinent factors; and

—The directors must decide, in the exercise of their reasonable business judgment and in light of their fiduciary duties under state law and under the Act, that there is a reasonable likelihood that a plan will benefit the fund and its shareholders.

The Commission also is adopting rule 17d–3 (17 CFR 270.17d–3) under the Act to provide an exemption from section 17(d) (15 U.S.C. 80a–17(d)) of the Act and rule 17d–1 (17 CFR 270.17d–1) thereunder, to the extent necessary, for agreements between a mutual fund and its affiliated persons whereby payments are made by the fund with respect to distribution, if such agreements are entered into in compliance with rule 12b–1. The Commission also is adopting certain disclosure and reporting requirements relating to use of assets for distribution, so that funds which bear distribution expenses in accordance with rule 12b–1 will disclose that fact to shareholders and prospective investors, as well as report it in registration statements filed with the Commission.

Background

In November, 1976, the Commission held public hearings on the use of fund assets for distribution.[1] After analyzing the comments and written submissions made at the hearings, the Commission reiterated its traditional view that it is generally improper under the Act for mutual funds to bear direct or indirect expenses related to the distribution of their shares.[2] However, the Commission has been reviewing the issue in light of public interest in and comment on the legal and policy implications of use of fund assets for distribution. In May, 1978, the Commission issued an Advance Notice of Proposed Rulemaking concerning conditions under which mutual funds might be permitted to bear distribution expenses.[3] Release No. 10252 stated the Commission's belief that it would be useful to explore further whether permitting mutual funds to finance distribution could, under some circumstances, benefit investors. It also solicited public comment on a variety of proposed conditions upon such use of assets designed to safeguard the interests of investors.

The Commission reevaluated the issue of funds bearing distribution expenses in view of the comments received in

[1] The hearings were announced in Investment Company Act Release No. 9470 (Oct. 4, 1976) (41 FR 44770, Oct. 12, 1976) ("Release No. 9470"). Copies of the hearing transcripts and written submissions made in connection with the hearings are filed in File No. 4–186.

[2] Investment Company Act Release No. 9915 (Aug. 31, 1977) (42 FR 44810, Sept. 7, 1977).

[3] Investment Company Act Release No. 10252 (May 23, 1978) (43 FR 23589, May 31, 1978) ("Release No. 10252").

response to Release No. 10252[4] and in view of the philosophy and objectives of the Investment Company Act Study being conducted by the Division of Investment Management. The Commission concluded that there were a number of difficulties with some of the conditions proposed in Release No. 10252. Accordingly, in September, 1979, the Commission proposed for public comment rule 12b–1 under the Act.[5] Generally, the proposed rule would make it unlawful for a mutual fund to finance distribution directly or indirectly except in compliance with the rule's substantive provisions. It would prescribe procedural requirements which are similar to those established by the Act for approval of investment advisory contracts, although the requirements of the proposed rule were more stringent. The substantive provisions of the proposed rule would place a great deal of responsibility on fund directors, especially the disinterested directors. The provisions were intended to insure that: (1) The disinterested directors would be free of domination or undue influence by management; (2) the directors would be fully informed and consider all relevant factors; and (3) the directors would exercise reasonable business judgment and would act in a manner consistent with their fiduciary duties.

Summary of Comments on Release No. 10862

Thirty-two comments were received on Release No. 10862.[6] Twenty-two commentators, associated primarily with the mutual fund industry, submitted statements favoring the use of fund assets for distribution.[7] Six commentators argued against such use of fund assets,[8] and one commentator refrained from taking any position on the propriety of a fund using its assets for distribution.[9] In general, most commentators objected to at least some of the provisions of proposed rules 12b–1 and 17d–3. Several commentators also questioned some general statements made by the Commission in Release No. 10862.

Several commentators challenged the fundamental premises underlying the proposed rule. A common statement made by those in favor of using fund assets for distribution was that no Commission rule was necessary to enable funds to finance distribution.[10] Instead, these commentators thought that directors could already authorize a fund to bear distribution expenses. Several commentators thought that the proposed rule would create uncertainty about purportedly well-established and current industry practice whereby the level of advisory fees reflects distribution expenses of the advisers.[11]

Three of the commentators who opposed the use of fund assets for distribution concluded that withdrawal of the proposed rule and a reaffirmation of the Commission's traditional position was warranted because of the assertedly irreconcilable conflicts of interest of fund advisers and because the shareholder benefit would not be as discernible as that of advisers, since advisers clearly benefit from increased sales of fund shares.[12] Dreyfus and Federated, which also opposed using fund assets for distribution, thought that the proposed rule would destroy the entrepreneurial incentives provided by the Act. Dreyfus concluded that the additional responsibilities placed on the disinterested directors would improperly transform their role from one of supervision to one of management. Dreyfus questioned the ability of the disinterested directors to assume the management functions described in Release No. 10862. The board of directors of a fund advised by Dreyfus and a disinterested director[13] from that fund made similar comments individually.

Several commentators criticized the Commission's reliance on section 12(b) for rulemaking authority with respect to distribution and argued that Congress intended section 12(b) (15 U.S.C. 80a–12(b)) to authorize the Commission to adopt rules only where a fund distributed its own shares without an external underwriter.[14] Instead, several submitted that any distribution rule with respect to funds which have principal underwriters should be promulgated only under section 15 of the Act.[15]

Some commentators, who argued in favor of permitting mutual funds to bear distribution expenses, urged the Commssion to adopt the standard for decision-making by fund disinterested directors established by *Tannenbaum* v. *Zeller*, 552 F.2d 402 (2d Cir.), *cert. denied*, 434 U.S. 934 (1977), as the only legal requirement in the distribution area.[16] In *Tannenbaum*, the Court of Appeals for the Second Circuit held that the disinterested directors of a fund did not breach their fiduciary duty to the fund in deciding to forgo recapture of brokerage commissions because: The directors were truly independent of the adviser; they were fully informed of all the available alternatives; and they had made a "reasonable business judgment" after thorough review of all relevant factors. Others would place responsibility with the entire board of directors and/or shareholders.[17] The ABA urged that any rule adopted should apply only to those funds which knowingly elect to use fund assets for distribution purposes.

Two commentators suggested conditions governing use of fund assets for distribution that were, in some respects, similar to the proposed rule. Scudder would be sympathetic to a permissive rule if the independent directors of a fund concluded, acting in good faith, that a fund would benefit from sales expenditures by the fund, and if there was adequate disclosure to and consent by the shareholders. A disinterested director of Vanguard

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[4] The comments are summarized in Investment Company Act Release No. 10862 (Sept. 7, 1979) (44 FR 54014, Sept. 17, 1979) ("Release No. 10862").

[5] Release No. 10862. Certain disclosure and reporting requirements relating to the use of fund assets for distribution were also proposed in Release No. 10862. In addition, the release contained proposed rule 17d–3 under the Act.

[6] Copies of the comments are filed in File No. S7–743. Two comments were filed too late to be included in this summary. However, neither contained comments that had not already been made by the other commentators on the proposed rule.

[7] American Bar Association ("ABA"), Capital Research and Management Company ("Capital Research"), The Fidelity Group of Mutual Funds ("Fidelity Group"), Fidelity Management and Research Company ("Fidelity Management"), Neil Flanagin, Gardner, Carton & Douglas ("Gardner"), Investment Company Institute ("ICI"), Investors Diversified Services, Inc. ("IDS"), Investors Group of Companies ("Investors Group"), Alice P. Jones ("Jones"), Jones & Babson, Inc. ("Babson"), Lord Abbett & Co. ("Lord Abbett"), Massachusetts Financial Services Company ("Mass. Financial"), John G. McDonald ("McDonald"), John R. Metcalf, National Association of Securities Dealers, Inc., Paine Webber Cashfund, Inc. ("Paine Webber"), Pilgrim Management Corporation ("Pilgrim"), Charles D. Root, Jr. ("Root"), Scudder, Stevens & Clark ("Scudder"), The Vanguard Group of Investment Companies ("Vanguard"), and Waddell & Reed, Inc. ("Waddell").

[8] American Bankers Association ("American Bankers"), The Dreyfus Corporation ("Dreyfus"), The Dreyfus Third Century Fund, Inc. ("Dreyfus Fund"), Federated Investors, Inc. ("Federated"), State of California, Department of Corporations ("Calif. Department of Corporations"), and Harold N. Warsawer ("Warsawer").

[9] The Association of the Bar of the City of New York ("NYC Bar").

[10] Capital Research, Fidelity Group, ICI, McDonald, and Waddell.

[11] ICI, NYC Bar, Paine Webber, and Waddell.

[12] American Bankers, Calif. Department of Corporations, and Warsawer.

[13] Jones.

[14] Gardner, ICI, Mass. Financial, Paine Webber, and Waddell.

[15] ABA, ICI, Mass. Financial, and Waddell.

[16] Gardner, ICI, IDS, and Lord Abbett.

[17] Federated, Mass. Financial, and McDonald (director approval), and Babson (director and shareholder approval). In the context of responding specifically to the voting provisions of the proposed rule, several commentators, including some who preferred the *Tannenbaum* standard, supported the general concept of shareholder and director approval. Others opposed the requirements for shareholder approval. *See* pp. 13–14 *infra*.

thought that shareholder interests would be protected by independent directors exercising reasonable business judgments on distribution arrangements where: (1) The independent directors have no connection to or conflicts of interest with investment advisers, distributors, or any other organizations rendering services to the fund; (2) the independent directors are fully informed and represent a diversity of talent; (3) actual distribution expenses, whether paid directly or indirectly, are disclosed to shareholders; and (4) the independent directors review annually the long-term cost effectiveness and benefits to shareholders of any distribution expenses.

Commentators expressed some support for the statement in Release No. 10862 that there would be an indirect use of fund assets for distribution if the advisory fee was inflated to provide the adviser with funds for that purpose [18] and agreement with the position that any rule on distribution should encompass both direct and indirect distribution expenses.[19] In general, however, the commentors either criticized or were confused by the statement that distribution expenses include direct and indirect expenses primarily intended to result in the sale of shares of a fund. The ABA thought that directors should consider whether there is any indirect use of fund assets only if the directors previously made an express determination that a portion of the advisory fee would be used by the adviser to pay distribution expenses. Two commentators [20] thought that, to the extent approval of an underwriting contract which diverted a portion of investors' payments from the fund to the underwriter is deemed to be an indirect distribution expense, a fund and its directors could comply with section 15(b) of the Act (15 U.S.C. 80a–15(b)) and still violate the proposed rule. Others [21] were uncertain whether the indirect bearing of distribution expenses was intended to be subject to the proposed rule. Two commentators [22] urged that the concept of "indirect expenses" be deleted from the proposed rule.

Many commentators misconstrued the discussion in Release No. 10862 of the Commission's longstanding position that an adviser may use its "legitimate" or "not excessive" profits to finance distribution. In the opinion of several, such statements represented an improper and unwarranted expansion of the fiduciary duty standard embodied in section 36(b) of the Act (15 U.S.C. 80a–35(b)).[23] A few commentators concluded that the proposed rule would establish a level of profit standard that was rejected by Congress in 1970, when Congress considered profit standards for investment advisory agreements but instead created the fiduciary duty standard under section 36 (15 U.S.C. 80a–35).[24] The ABA and the ICI thought that every externally managed fund would be forced to adopt the procedures within the proposed rule rather than risk a later determination that the adviser's profits were not legitimate and that the failure to adopt a plan resulted in a violation of the rule. Fidelity Management, on the other hand, thought that the rule would discourage an adviser from using any of its profits for distribution for fear of second guessing by the Commission.

Many of the specific conditions suggested by the Commission drew extensive criticism from the commentators. For example, several objected to the definition of distribution expenses, part of which included a non-exclusive list of activities that would be deemed distribution expenses. Instead, the commentators recommended that the definition be changed to recite precisely all activities that would be deemed distribution expenses.[25]

Similarly, commentators criticized the requirement for two-thirds approval by shareholders and directors for the implementation of a distribution plan. They concluded that, since the potential for conflict in the decision whether a fund should bear distribution expenses would assertedly be no greater than the conflict involved in approving the advisory contract, a majority vote by shareholders and directors should be sufficient to approve a distribution plan,[26] and that there was no statutory basis for the more stringent voting requirements in the proposed rule.[27] Several commentators thought that it would be expensive [28] and difficult [29] for a fund to achieve such a high percentage of shareholder approval. Capital Research and Vanguard were of the opinion that, after the initial shareholder approval of a distribution plan, choice of specific arrangements to be used from time to time should be within the discretion of the board of directors. Capital Research argued against requiring shareholder approval after each adjustment to the basic plan. Other commentators saw no need to require any shareholder approval for a distribution plan proposal.[30]

Several commentators urged the Commission to eliminate the nominating committee requirement because they viewed it as unnecessary,[31] founded on erroneous premises,[32] inconsistent with the Act,[33] and creating additional problems.[34] Commentators also questioned the Commission's views in Release No. 10862 as to the possible lack of independence of independent directors, in light of the analysis by the Supreme Court in *Burks* v. *Lasker*, 99 S. Ct. 1831 (1979), concerning the role of disinterested directors.[35] Vanguard was the only commentator that expressly approved of the requirement that the selection and nomination of disinterested directors be committed to the discretion of the disinterested directors. Several commentators thought that, if the nominating committee concept is preserved in the proposed rule, interested directors should be allowed to participate in the nominating process.[36]

With respect to the requirement that the directors weigh all pertinent factors before deciding to use fund assets for distribution, including a list of nine requisite factors, a majority of commentators on this point preferred the Commission to issue a release incorporating the nine factors.[37] In such a format, they contended, the directors could be made aware of their obligations to consider each factor without the rigidity that they feared would occur if the factors became mandatory provisions in a rule.

The standard of care required of directors in implementing a distribution plan was viewed with concern by some commentators, who thought the standard suggested that there may be fiduciary duties under state law or under the Act which are inconsistent

[18] Lord Abbett.

[19] Vanguard.

[20] Fidelity Management and Paine Webber.

[21] Pilgrim and Vanguard.

[22] Babson and Pilgrim.

[23] ABA, Federated, IDS, and Waddell.

[24] Federated, NYC Bar, and Waddell.

[25] ABA, ICI, IDS, and NYC Bar.

[26] ABA, Capital Research, Federated, ICI, IDS, Investors Group, NYC Bar, Paine Webber, Pilgrim, Root, and Vanguard.

[27] Babson, Fidelity Management, Gardner, ICI, Mass. Financial, NYC Bar, and Waddell.

[28] ABA, IDS, and Paine Webber.

[29] ABA, Fidelity Management, Gardner, ICI, Lord Abbett, NYC Bar, and Paine Webber.

[30] Fidelity Management, Lord Abbett, and Scudder.

[31] Federated, Lord Abbett, and ICI.

[32] ABA, Federated, Fidelity Group, ICI, Paine Webber, and Pilgrim.

[33] ABA, Federated, Fidelity Group, ICI, Mass. Financial, and NYC Bar.

[34] Dreyfus Fund.

[35] ABA, Federated, Fidelity Group, ICI, and Paine Webber.

[36] ABA, Capital Research, and Fidelity Management.

[37] ABA, Fidelity Management, ICI, Investors Group, and Lord Abbett.

with a business judgment standard.[38] Instead, these commentators joined Mass. Financial in the view that a business judgment standard alone would be appropriate when directors considered adopting a distribution plan.

Release No. 10862 stated that the proxy statement relating to a proposal to use fund assets for distribution would have to describe all material aspects of the plan and all material aspects of any agreements relating to implementation of the plan and it listed numerous disclosure items. The few comments that were received on this portion of the proposed rule generally supported the concept of full disclosure to investors.[39] The Fidelity Group concluded that meaningful disclosure would be the most practical check on excessive commitments of fund assets for distribution expenses. Fidelity Management, however, objected to the list of items in Release No. 10862 that were deemed to be required disclosure items because it was concerned that such a pattern of regulation could be expected to expand into other areas.

Release No. 10862 noted that the Commission has taken the preliminary position in the *Vanguard* [40] proceeding that a fund which bears distribution expenses but which does not charge a front end sales load cannot refer to itself as a "no-load" fund or use equivalent terminology. Release No. 10862 stated further that the Commission would not change its position at this time but that further consideration would be given to the "no-load" issue in connection with the *Vanguard* proceeding. Scudder, adviser to eight "no-load" funds, argued that, if the term "no-load" could be applied where a fund pays promotional expenses, the term would lose its meaning. On the other hand, a few commentators argued that there was no justification for the position taken in the *Vanguard* proceeding because the Act makes a distinction between a "sales load" and "sales or promotional expenses," [41] and because such a prohibition would not necessarily result in fair disclosure.[42]

Commentators on proposed rule 17d–3 requested that the Commission clarify the effects of such a rule,[43] requested that the rule be expanded to encompass fund complexes,[44] and challenged the Commission's asserted characterization of situations raising questions under section 17(d) of the Act.[45] The ICI and IDS objected to what they considered the Commission's position that funds with a common adviser, directors and/or officers are affiliated persons of one another. Paine Webber objected to what it viewed as the assumption in proposed rule 17d–3 that a traditional advisory or distribution agreement involving a single fund and its underwriter is subject to rule 17d–1. Federated and Vanguard argued that distribution services would be done most efficiently on a group-sharing basis and that proposed rule 17d–3 ignores the fact that fund complexes, rather than individual funds, dominate the industry. The ABA questioned whether the proposed rule would apply only with respect to a single fund within a complex, to funds not within a complex, or to several funds within a complex.

Discussion

After a thorough review of the comments on proposed rule 12b–1 and the companion rules, the Commission has decided to adopt the rules substantially as proposed in Release No. 10862. In response to the comments, however, the Commission has made certain modifications to proposed rule 12b–1, which are discussed below. Since there may be circumstances under which it would be appropriate for a fund to bear its distribution expenses, the Commission believes there should be some latitude for fund directors to exercise their business judgment to authorize such a use of fund assets. Nevertheless, the Commission still remains generally concerned about: (1) The conflicts which may exist between the interests of a fund and those of its investment adviser in deciding whether a fund should pay its distribution costs; (2) the likelihood that the fund will benefit from paying for such costs, and (3) the fairness to existing shareholders. Therefore, the Commission believes that any permissive rule in this area must contain substantive standards to protect fund shareholders, guidelines to ensure an orderly process of decision-making by directors, and accountability for exercising the authority to use fund assets for distribution. The Commission has concluded that proposed rule 12b–1, as modified, and its companion rules establish an appropriate regulatory balance and should be adopted. The Commission and its staff will monitor the operation of the rules closely and will be prepared to adjust the rules in light of experience to make the restrictions on use of fund assets for distribution either more or less strict.

The Legal Authority To Adopt Proposed Rule 12b–1

Before proposing rule 12b–1 the Commission twice received public comment on its legal authority to regulate the direct or indirect use of fund assets for distribution. The release announcing the public hearings which were held in November, 1976, suggested as an issue for consideration: "What, if any, authority does the Commission have to adopt rules which would permit, prohibit, or limit the use of fund assets to pay distribution expenses?" [46] The Advance Notice of Proposed Rulemaking [47] stated that any ensuing rule proposal would be under section 12(b).

Relatively few of the presentations at the public hearings discussed the legal issues associated with the regulation of fund distribution expenses, but the prevalent view among those who did was that, although the Act did not necessarily prohibit the financing of distribution by funds, the Commission had the legal authority under the Act to prohibit or limit such activity. Of the 51 persons who commented on the Advance Notice, only three questioned the Commission's legal authority under section 12(b); only two argued affirmatively that the Commission lacks the authority to regulate expenditures by funds which have principal underwriters.

However, a significant number of the commentators on Release No. 10862 questioned the Commission's legal authority, so it is important to set forth fully the Commission's basis for relying primarily on section 12(b) for authority to regulate the use of fund assets for distribution.[48] Section 12(b) provides:

It shall be unlawful for any registered open-end company (other than a company complying with the provisions of section 10(d)) to act as a distributor of securities of

[38] ABA, Federated, and ICI.

[39] Fidelity Group, Fidelity Management, and Lord Abbett.

[40] For a full discussion of this issue, see *In Re The Vanguard Group, Inc.*, Initial Decision, Admin. Proc. File No. 3–5281, 21 (Nov. 29, 1978).

[41] Paine Webber and Vanguard.

[42] Gardner and Paine Webber.

[43] ABA.

[44] Federated, Root, and Vanguard.

[45] ICI, IDS, and Paine Webber.

[46] Release No. 9470.

[47] Release No. 10252.

[48] It must be noted that the Commission is also relying on other sources of authority as well. Section 38(a) of the Act (15 U.S.C. 80a–37(a)) gives the Commission general authority to adopt rules "necessary or appropriate to the exercise of the powers conferred" elsewhere in the Act and specifically authorizes the Commission to define "accounting, technical, and trade terms" used in the Act. The latter phrase is significant because the term "distributor" in section 12(b) is not defined. In addition, section 17(d) of the Act authorizes the Commission to adopt rules regulating certain joint transactions involving investment companies and their affiliated persons and principal underwriters. The Commission is exercising its authority under section 17(d) to permit arrangements for use of fund assets for distribution which involve covered joint transactions only if such arrangements comply with rule 12b–1.

which it is the issuer, except through an underwriter, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Many commentators argued that the Commission has no authority under this provision to regulate the distribution financing activities of funds which have principal underwriters because of the phrase "except through an underwriter." Most of these commentators believed that other provisions of the Act, primarily section 15(b), govern the distribution efforts of funds which have principal underwriters. Some contended that the proposed rule was inconsistent with the basic statutory scheme regulating the relationships between funds and their investment advisers and principal underwriters established by sections 10 and 15 of the Act (15 U.S.C. 80a–10, 80a–15) because some of the procedural and substantive requirements of the proposed rule were more rigorous than similar provisions in the Act.

Section 12(b) was intended to permit the Commission to regulate the use of mutual fund assets to finance distribution. Commission spokesman David Schenker testified that the purpose of the section was to protect funds "against excessive sales, promotion expenses, and so forth."[49] The phrase "except through an underwriter" does not deprive the Commission of authority over the distribution financing activities of funds which have underwriters. If a fund finances distribution, it becomes so actively and intimately involved in the distribution process that, even if it contracts with an underwriter, it cannot fairly be said to be distributing *through* that underwriter. Such a fund should more properly be viewed as acting as a distributor *along with* the underwriter.

Nevertheless, it is argued that section 15(b) of the Act is the exclusive source of authority to regulate the distribution arrangements of funds with underwriters. However, that section, in contrast to Section 12(b), provides no alternative mechanism for the regulation of fund expenditures to promote distribution. It would appear that section 15(b) is designed to regulate traditional underwriting arrangements, i.e., those where underwriters get their compensation from sales loads. Unlike section 15(a) (15 U.S.C. 80a–15(a)), Section 15(b) does not require any description of the compensation to be paid to the underwriter. This difference presumably exists because Congress did not expect funds to pay underwriters anything. It would appear that Congress sought to regulate under section 15(b) only distribution arrangements as it understood them to exist and did not comtemplate the bearing of distribution expenses by funds which have underwriters. Therefore, it is inconsistent with the purposes of the Act to conclude that Section 15(b) is the exclusive source of regulation of fund expenditures to promote distribution.

General Requirements

Many commentators were critical of the inclusion of indirect distribution expenses within the scope of the rule. Some appeared confused about what might constitute indirect expenses, and others recommended that the rule apply only to direct expenditures. One commentator recommended that directors consider whether there is an indirect use of fund assets only if the directors made an express determination that part of the advisory fee would be used for fund distribution expenses. Accepting these recommendations would make evasion of the rule easy. The Commission has historically been concerned with whether funds are paying for distribution in substance and not with the form of particular arrangements. In this connection, it should be noted that section 48(a) of the Act (15 U.S.C. 80a–47(a)) in effect prohibits doing indirectly that which cannot be done directly. Therefore, the Commission believes that the rule should apply to indirect expenses as well as direct expenses.

However, in light of the uncertainty evinced by the commentators, some further explanation is in order. If a mutual fund makes payments which are earmarked for distribution, that is obviously a direct use of fund assets for distribution. If a fund makes payments which are ostensibly for some other purpose, and the recipient of those payments finances distribution, the question arises whether the fund's assets are being used indirectly. The Commission's position has been and continues to be that there can be no precise definition of what types of expenditures constitute indirect use of fund assets. That judgment will have to be made based on the facts and circumstances of each individual case. Under proposed rule 12b–1, fund directors, particularly the disinterested directors, would bear substantial responsibility for making that judgment. Under sections 15(a) and (c) of the Act they are also responsible for evaluating and deciding whether to approve the advisory contract. In fulfilling these obligations directors of mutual funds would have to give careful scrutiny to any past, present or planned expenditures by the investment adviser for distribution, and determine on the basis of the facts of each particular case whether such expenditures constituted an indirect use of fund assets in violation of their fiduciary obligations under section 36 of the Act and in contravention of the rule. The Commission and its staff will continue to scrutinize arrangements which appear to involve the indirect use of fund assets for distribution.

Much of the confusion among the commentators arose from the description in Release No. 10862 of the effect proposed rule 12b–1 would have on advisers who bear the cost of distribution. Many commentators misconstrued the Commission's reaffirmation of its position that distribution financing activities by investment advisers do not necessarily involve an indirect use of fund assets. It is hoped that the following explanation will clarify the Commission's position. It is the Commission's view that, an indirect use of fund assets result if any allowance is made in the adviser's fee to provide money to finance distribution. Therefore, when an adviser finances distribution, fund directors, in discharging their responsibilities in connection with approval of the advisory contract, must satisfy themselves either that the management fee is not a conduit for the indirect use of the fund's assets for distribution or that the rule has been complied with. However, under the rule there is no indirect use of fund assets if an adviser makes distribution related payments out of its own resources. In determining whether there is an indirect use of fund assets, it is appropriate to relate a fund's payments pursuant to the advisory contract to the adviser's expenditures for distribution and to view such expenditures as having been made from

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[49] H.R. 10065, *Investment Trusts and Investment Companies: Hearings Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong. 3d Sess. 112 (1940) (testimony of Commission spokesman David Schenker). H.R. 10065, which became law, embodied a compromise accepted both by the Commission and representatives of the investment company industry. (*Id.* at 15–16.) Shortly after passage of the Act, Alfred Jaretzki, who had participated in drafting the Act as a representative of closed-end companies, wrote about section 12(b):

[a]pparently the Commission was particularly fearful of the possibility that open-end investment companies in their formative stages might be made to shoulder the unprofitable burden of selling and distributing their shares during this period of heavy expenses and small return, building up the investment company for the benefit of some controlling person.

Jaretzki, *The Investment Company Act of 1940*, 26 Wash. U.L.Q. 303, 324–25 (1941) (footnote omitted).

the adviser's profits, if any, from the advisory contract. To the extent that such profits are "legitimate" or "not excessive", the adviser's distribution expenses are not an indirect use of fund assets. Many commentators drew unwarranted inferences from the use of "legitimate" and "not excessive" in Release No. 10862. Profits which are legitimate or not excessive are simply those which are derived from an advisory contract which does not result in a breach of fiduciary duty under section 36 of the Act. The courts have not established definitive standards for determining what does or does not constitute a breach of fiduciary duty in the compensation area, and, although the Commission reserves the right to express its own views of what such standards should be, it has not done so.

Some commentators suggested that the definition of distribution expenses recite precisely all activities that would be deemed distribution expenses. Recognizing that new distribution activities may continuously evolve in the future, and in view of the impracticability of developing an all-inclusive list, the Commission maintains that the better approach is to define distribution expenses in conceptual terms (e.g., financing activities primarily intended to result in the sale of fund shares).

Procedural Requirements

The Commission has reevaluated the requirement in the proposed rule for two-thirds approval by shareholders in light of comments about the practical difficulties funds anticipated in getting sufficient shareholder participation, as distinct from approval, to meet the two-thirds requirement. Consequently, the rule, as adopted, requires only a majority shareholder vote. The Commission believes that the approval requirements, including the requirement of director approval, are sufficient to protect adequately shareholder interests in deciding whether it is necessary or appropriate for a fund to bear its distribution expenses. In addition, the Commission does not believe it is necessary to impose the extraordinary requirement that two-thirds of the disinterested directors and of the board as a whole approve the use of fund assets for distribution. It is not clear that the practical effect of such a requirement would justify deviation from the normal requirement of a majority vote, especially since in most cases it would require the support of as many disinterested directors to achieve a majority vote as it would to achieve a two-thirds vote.

The rule has also been amended to clarify that, subsequent to the adoption of a distribution plan, only modifications which would materially increase the amount of money to be spent need be submitted to the shareholders for approval. Moreover, agreements pursuant to a plan will not be subjected to a shareholder vote. The Commission recognizes that once a distribution plan has been approved in the manner prescribed in the rule, directors should be allowed some discretion to modify agreements with the providers of distribution services as the circumstances change.

Independence of Directors

Permitting the use of fund assets for distribution is a major regulatory change for the Commission. This change reflects both altered circumstances and a determination by the Commission that adoption of rule 12b–1 is appropriate in light of the regulatory reform objectives of the Investment Company Act Study. Two central goals of the Study are to permit investment companies to exercise wider latitude in making business judgments without Commission approval and to enhance the role of directors, particularly the disinterested directors, in scrutinizing investment company affairs. These goals are interdependent in that the more capable the disinterested directors are of overseeing the kinds of activities of investment companies which are of regulatory significance, the more the Commission will be willing to reduce regulatory restrictions.

The Commission views a decision to use fund assets for distribution as a particularly difficult business judgment which is complicated by the conflicts of interest which are present. Since rule 12b–1 does not restrict the kinds or amounts of payments which could be made, the role of the disinterested directors in approving such expenditures is crucial. No formal provisions in a rule can insure that directors will make the right decision in every instance; however, the likelihood that a decision will be in the best interests of a fund and its shareholders will be increased if the disinterested directors are genuinely independent of management. Of course, a requirement that the tenure of disinterested directors be independent of management control will not guarantee that disinterested directors will in fact be independent. Nevertheless, experience indicates that such formal independence will breed an atmosphere in which actual independence will develop. The well-documented trend among corporations generally toward director independence (e.g., the increasing number of boards which have independent majorities and majority independent committees, including nominating committees) strongly implies a recognition of the validity of this proposition. Accordingly, the Commission believes that, in order for rule 12b–1 to be effective, disinterested directors must be independent.

The Commission remains concerned that there will be situations in which disinterested directors may not be able to act with complete independence in deciding whether to use fund assets for distribution because of the possibility that the advisers' control over the funds they advise could lead to domination of or undue influence over the disinterested directors. The Commission recognizes that many advisers who control the funds they advise would not attempt to misuse such control over the disinterested directors and that many disinterested directors are fully independent. However, the Commission still believes that it is appropriate to enhance the independence of disinterested directors by adopting the provisions of paragraph (c) as proposed. This belief reflects the cumulative experience of the staff in regulating the mutual fund industry and, for that reason, citations of such cases as *Burks* v. *Lasker* [50] are not apposite. Whatever *Burks* or *Tannenbaum* may have said about the theoretical role of disinterested directors or about the actual independence of the directors who were involved in those cases, it is the Commission's view that as a general proposition disinterested directors should not be entrusted with a decision on use of fund assets for distribution without receiving the benefit of measures designed to enhance their ability to act independently.

With respect to the argument that paragraph (c) is extra statutory, the Commission acknowledges that there are no identical provisions in the Investment Company Act, although

[50] 99 S. Ct. 1831. In *Burks* the Supreme Court held, in part, that the Act did not forbid disinterested directors from terminating non-frivolous law suits. In that case, the Court did not pronounce generally that under all circumstances disinterested directors are able to act with genuine independence. Instead, the court recognized that because of the potential conflicts, "some restraints upon the unfettered discretion of even disinterested mutual fund directors, particularly in their transactions with the investment adviser" may be justified (at 1839). Although the Commission does not view the measures in the rule which will enhance the independence of disinterested directors to be restraints upon such directors, the Commission believes that such measures, in the context of a permissive rule to allow funds to pay distribution expenses, are consistent with the Supreme Court's caution concerning the role of disinterested directors and are necessary and appropriate.

section 15(f) contains provisions of similar import.[51] Nevertheless, the Commission believes that paragraph (c) is a reasonable restriction. That provision does not impose a new regulatory requirement on all investment companies; instead it makes available an exemption from regulation for companies which elect to institute a corporate governance mechanism which, as suggested above, is consistent with salutary developments among corporations of all types.

Factors

In order to avoid the appearance of either unduly constricting the directors' decision making process or of creating a mechanical checklist, the Commission has decided to delete the list of factors from rule 12b–1. However, in order to insure a proper record of the deliberative process, the rule will require preservation of minutes. Since corporate minutes are frequently cryptic, the rule requires explicitly that these minutes set forth the factors the directors considered, together with an explanation of the basis for the decision to sue fund assets for distribution.

Although the Commission has decided not to require directors to consider any particular factors, the Commission believes that the factors enumerated in rule 12b.1 would normally be relevant to a determination of whether to use fund assets for distribution. Therefore, it appears that setting forth those factors in this release may provide helpful guidance to directors. The following list of factors is the same as the list contained in proposed rule 12b–1, except for slight amplification of the fourth factor:

(1) Consider the need for independent counsel or experts to assist the directors in reaching a determination;

(2) Consider the nature of the problems or circumstances which purportedly make implementation or continuation of such a plan necessary or appropriate;

(3) Consider the causes of such problems or circumstances;

(4) Consider the way in which the plan would address these problems or circumstances and how it would be expected to resolve or alleviate them, including the nature and approximate amount of the expenditures; the relationship of such expenditures to the overall cost structure of the fund; the nature of the anticipated benefits, and the time it would take for those benefits to be achieved;

(5) Consider the merits of possible alternative plans;

(6) Consider the interrelationship between the plan and the activities of any other person who finances or has financed distribution of the company's shares, including whether any payments by the company to such other person are made in such a manner as to constitute the indirect financing of distribution by the company;

(7) Consider the possible benefits of the plan to any other person relative to those expected to inure to the company;

(8) Consider the effect of the plan on existing shareholders; and

(9) Consider, in the case of a decision on whether to continue a plan, whether the plan has in fact produced the anticipated benefits for the company and its shareholders.

Reasonable Business Judgment

The Commission is adopting the standard of care required of directors in implementing a distribution plan as proposed originally in Release No. 10862. The Commission intentionally did not define the relationship between a "reasonable business judgment" and "fiduciary duties" under state law and under sections 36 (a) and (b) of the Act, nor did it define those director activities that would be consistent with each concept. The Commission did this in recognition that the concepts are constantly evolving and, particularly, that there have been no comprehensive or definitive interpretations of the various fiduciary duty requirements of section 36. Certainly it was not the Commission's intent to assert any such interpretation of its own. Rather, as stated clearly in Release No. 10862, paragraph (e) incorporates directors' existing duties in order to emphasize that formal compliance with the other provisions of the rule will not establish a safe harbor. The Commission believes that the standards for accountability placed on the directors concerning their decision to implement a distribution plan are necessary and are consistent with the standards under the Act and under state law required of fund directors in other decision making contexts.

Disclosure and Reporting Requirements

The Commission is adopting the disclosure and reporting requirements substantially as proposed in Release No. 10862 for the reasons stated in that release.[52] As noted above, the few comments that were received on the disclosure and reporting requirements generally supported the concept of full disclosure to investors. Moreover, the Commission continues to believe that it is inappropriate, at this time, to modify the position taken in the *Vanguard* proceeding that a fund which bears distribution expenses but which does not charge a front-end sales load cannot refer to itself as a "no-load" fund or use equivalent terminology. Instead, the Commission remains of the opinion that it is more appropriate to give further consideration to this issue within the context of the *Vanguard* proceeding.

Proposed Rule 17d-3

The Commission is adopting rule 17d-3 as proposed in Release No. 10862. One commentator asked whether the rule 17d-3 exemption would apply to several funds within a complex. Each fund within a complex can make individual and independent determinations, in accordance with the provisions of rule 12b-1, to bear its own distribution expenses. To the extent that each fund independently decides to bear its own distribution expenses, and to the extent that the provisions of section 17(d) and rule 17d-1 would otherwise apply, the exemption under rule 17d-3 is available. However, the Commission remains of the opinion that it would be inappropriate, in view of the *Vanguard* proceeding, to extend rule 17d-3 to arrangements for the joint sharing of distribution costs by funds which are affiliates (or affiliates of affiliates) of each other. The Commission wished to emphasize that it has no intention of categorizing certain transactions as raising the applicability of section 17(d) and rule 17d-3 of the Act. The Commission's only comment is that, to the extent that arrangements in which a fund pays for its distribution costs would involve the fund in a "joint enterprise" with an affiliated person, and if such arrangements were entered into in compliance with rule 12b-1, the Commission sees no need for prior Commission review and approval of the arrangements.

Authority, Effective Date

The Commission, pursuant to section 12(b) (15 U.S.C. 80a-12(b)), and section 38(a) (15 U.S.C. 80a-37(a)) of the Act hereby amends 17 CFR Part 270 by adding new § 270.12b-1. Further, the Commission pursuant to section 17(d) (15 U.S.C. 80a-17(d)) and 38(a) of the Act hereby amends 17 CFR Part CFR Part 270 by adding new § 270.17d-3. Finally, the Commission is amending 17 CFR Part 239 and 17 CFR Part 274 by amending § 239.15 and § 274.11, pursuant to sections 6, 7, 8, 19, and 19(a)

[51] Section 15(f) requires, inter alia, that the board be three-fourths disinterested for three years after a sale of an interest in the investment adviser resulting in assignment of the advisory contract.

[52] The Commission has slightly amended proposed new Item 9, Part II, Form N–1 (17 CFR 239.15, 274.11) in order to facilitate monitoring of expenditures for distribution.

of the Securities Act of 1933 (15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a)), and sections 8 (15 U.S.C., 80a-8) and 38(a) of the Act. This action is effective immediately pursuant to the Administrative Procedure Act (15 U.S.C. 553(d)(1)).

I. Chapter II of Title 17 of the Code of Federal Regulations is amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. Adding a new § 270.12b-1 as follows:

§ 270.12b–1 Distribution of shares by registered open-end management investment company.

(a)(1) Except as provided in this section, it shall be unlawful for any registered open-end management investment company (other than a company complying with the provisions of section 10(d) of the Act (15 U.S.C. 80a–10(d))) to act as a distributor of securities of which it is the issuer, except through an underwriter.

(2) For purposes of this section, such a company will be deemed to be acting as a distributor of securities of which it is the issuer, other than through an underwriter, if it engages directly or indirectly in financing any activity which is primarily intended to result in the sale of shares issued by such company, including, but not necessarily limited to, advertising, compensation of underwriters, dealers, and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature.

(b) A registered, open-end management investment company ("Company") may act as a distributor of securities of which it is the issuer: *Provided,* That any payments made by such company in connection with such distribution are made pursuant to a written plan describing all material aspects of the proposed financing of distribution and that all agreements with any person relating to implementation of the plan are in writing: *And further provided,* That:

(1) Such plan has been approved by a vote of at least a majority of the outstanding voting securities of such company;

(2) Such plan, together with any related agreements, has been approved by a vote of the board of directors of such company, and of the directors who are not interested persons of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan, cast in person at a meeting called for the purpose of voting on such plan or agreements; and

(3) Such plan or agreement provides, in substance:

(i) That it shall continue in effect for a period of more than one year from the date of its execution or adoption only so long as such continuance is specifically approved at least annually in the manner described in paragraph (b)(2) of this section;

(ii) That any person authorized to direct the disposition of monies paid or payable by such company pursuant to the plan or any related agreement shall provide to the company's board of directors, and the directors shall review, at least quarterly, a written report of the amounts so expended and the purposes for which such expenditures were made; and

(iii) In the case of a plan, that it may be terminated at any time by vote of a majority of the members of the board of directors of the company who are not interested persons of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan or by vote of a majority of the outstanding voting securities of such company; and

(iv) In the case of an agreement related to a plan,

(A) That it may be terminated at any time, without the payment of any penalty, by vote of a majority of the members of the board of directors of such company who are not interested persons of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to any other party to the agreement, and

(B) For its automatic termination in the event of its assignment; and

(4) Such plan provides that it may not be amended to increase materially the amount to be spent for distribution without shareholder approval and that all material amendments of the plan must be approved in the manner described in paragraph (b)(2) of this section;

(5) Such plan is implemented and continued in a manner consistent with the provisions of paragraphs (c), (d), and (e) of this section;

(c) A registered open-end management investment company may rely on the provisions of paragraph (b) of this section only if selection and nomination of those directors who are not interested persons of such company are committed to the discretion of such disinterested directors;

(d) In considering whether a registered open-end management investment company should implement or continue a plan in reliance on paragraph (b) of this section, the directors of such company shall have a duty to request and evaluate, and any person who is a party to any agreement with such company relating to such plan shall have a duty to furnish, such information as may reasonably be necessary to an informed determination of whether such plan should be implemented or continued; in fulfilling their duties under this paragraph the directors should consider and give appropriate weight to all pertinent factors, and minutes describing the factors considered and the basis for the decision to use company assets for distribution must be made and preserved in accordance with paragraph (f) of this section;

Note.—For a discussion of factors which may be relevant to a decision to use company assets for distribution, see Investment Company Act Releases Nos. 10862, September 7, 1979, and 11414, October 28, 1980.

(e) A registered open-end management investment company may implement or continue a plan pursuant to paragraph (b) of this section only if the directors who vote to approve such implementation or continuation conclude, in the exercise of reasonable business judgment and in light of their fiduciary duties under state law and under sections 36(a) and (b) (15 U.S.C. 80a–35 (a) and (b)) of the Act, that there is a reasonable likelihood that the plan will benefit the company and its shareholders; and

(f) A registered open-end management investment company must preserve copies of any plan, agreement or report made pursuant to this section for a period of not less than six years from the date of such plan, agreement or report, the first two years in an easily accessible place.

2. Adding a new § 270.17d–3 as follows:

§ 270.17d–3 Exemption relating to certain joint enterprises or arrangements concerning payment for distribution of shares of a registered open-end management investment company.

An affiliated person, of, or principal underwriter for, a registered open-end management investment company and an affiliated person of such a person or principal underwriter shall be exempt from section 17(d) of the Act (15 U.S.C. 80a–17(d)) and rule 17d–1 thereunder (17 CFR 270.17d–1), to the extent necessary to permit any such person or principal underwriter to enter into a written

agreement with such company whereby the company will make payments in connection with the distribution of its shares, *Provided*, That:

(a) Such agreement is made in compliance with the provisions of § 270.12b–1; and

(b) No other registered management investment company which is either an affiliated person of such company or an affiliated person of such a person is a party to such agreement.

II. Chapter II of Title 17 of the Code of Federal Regulations is amended as follows:

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

1. By adding new Item 1(b)(15), Part II of Form N–1 as follows:

§ 239.15 Form N–1 for open-end management investment companies registered on Form N–8A.

§ 274.11 Form N–1, registration statement of open-end management investment companies.

* * * * *

Item 1. Financial Statements and Exhibits.

* * * * *

(b) Exhibits:

* * * * *

(15) copies of any plan entered into by Registrant pursuant to rule 12b–1 under the 1940 Act, which describes all material aspects of the financing of distribution of Registrant's shares, and any agreements with any person relating to implementation of such plan.

2. By adding new Item 9, Part II, of Form N–1 and renumbering current Item 9 in Part II as Item 10:

§ 239.15 Form N–1 for open-end management investment companies registered on Form N–8A.

§ 274.11 Form N–1, registration statement of open-end management investment companies.

* * * * *

Item 9. Distribution Expenses.

Furnish a summary of the material aspects of any plan pursuant to which the Registrant incurs expenses related to the distribution of its shares, and of any agreements related to the implementation of such a plan. The summary should include, among other material information, the following:

(a) The amounts paid by the Registrant under the plan during the last fiscal year, as a total dollar amount and a percentage of Registrant's average net assets during that period;

(b) The manner in which such amount was spent on:

(i) Advertising,

(ii) Printing and mailing of prospectuses to other than current shareholders,

(iii) Compensation to underwriters,

(iv) Compensation to dealers,

(v) Compensation to sales personnel, and

(vi) Other (specify).

(c) Whether any of the following persons had a direct or indirect financial interest in the operation of the plan or related agreements:

(i) Any interested person of the Registrant; or

(ii) Any director of the Registrant who is not an interested person of the Registrant.

(d) The benefits, if any, to the Registrant resulting from the plan.

Instruction: In responding to this item the Registrant should take note of the requirements of rule 12b–1 under the 1940 Act (17 CFR 270.12b–1).

By the Commission.

George A. Fitzsimmons,

Secretary.

October 28, 1980.

[FR Doc. 80–34786 Filed 11–6–80; 8:45 am]

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17 CFR Parts 240 and 249

[Release No. 34–17258, File No. S7–590]

Filings by Self-Regulatory Organizations of Proposed Rule Changes and Other Materials with the Commission

AGENCY: Securities and Exchange Commission.

ACTION: Final rules and form; revocation of rule and form.

SUMMARY: The Commission is amending the requirements applicable to the filing by self-regulatory organizations of proposed rule changes and certain other materials. The amendments, which are intended to facilitate the review of proposed rule changes, (i) specify in greater detail the information required in a filing; (ii) expand the categories of proposed rule changes that may become effective summarily to include certain rules effecting changes in existing services of registered clearing agencies; and (iii) clarify which actions of self-regulatory organizations are proposed rule changes. In addition, the Commission is revoking the requirement that self-regulatory organizations file stated policies, practices, and interpretations not deemed to be rules. The Commission is also revoking requirements that each national securities exchange or registered securities association file separately information about its rules in effect on June 4, 1975, and certain forms, reports, or questionnaires. Finally, the Commission is adopting a rule requiring registered clearing agencies to file material they make generally available. The Commission is withdrawing, in a separate release, proposals relating to these matters.

EFFECTIVE DATE: January 1, 1981.

FOR FURTHER INFORMATION CONTACT: Susan Davis, Esq., (202) 272–2828; or Jeffrey Jordan, Esq., (202) 272–2847, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today announced the following action with respect to proposals in its May 1979 release [1] (the "Proposal Release") to facilitate review of proposed rule changes of self-regulatory organizations under Section 19(b) [2] of the Securities Exchange Act of 1934 (the "Act"): [3]

(1) Adoption of amendments to Rule 19b–4 under the Act,[4]

(A) Clarifying which actions of a self-regulatory organization constitute proposed rule changes,

(B) Providing summary effectiveness for certain rules changing existing services of registered clearing agencies,

(C) Eliminating the requirement that a self-regulatory organization file on Form 19b–4B [5] notice of stated policies, practices, and interpretations not deemed to be rules, and

(D) Eliminating the requirement that each national securities exchange and registered securities association file information about its rules in effect on June 4, 1975.

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[1] Securities Exchange Act Release No. 15838 (May 18, 1979), 44 FR 30924 (May 29, 1979). The Commission received comments in response to the Proposal Release from the American Stock Exchange, Inc. ("Amex"), Chicago Board Options Exchange, Inc. ("CBOE"), Depository Trust Company ("DTC"), Municipal Securities Rulemaking Board ("MSRB"), National Association of Securities Dealers, Inc. ("NASD"), National Securities Clearing Corporation ("NSCC"), New York Stock Exchange, Inc. ("NYSE"), and Options Clearing Corporation ("OCC"). Securities and Exchange Commission File No. S7–590 ("File No. S7–590").

[2] 15 U.S.C. 78s(b). Section 19(b) requires a self-regulatory organization to file with the Commission each of its proposed rule changes, accompanied by a concise general statement of the basis and purpose of the proposed rule change. A proposed rule change cannot take effect unless the Commission approves it, or it is otherwise permitted to become effective under Section 19(b). To approve a proposed rule change, the Commission must find that the rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization proposing the rule change.

[3] 15 U.S.C. 78a *et seq.*

[4] 17 CFR 240.19b–4. Rule 19b–4 was adopted in August 1975. Securities Exchange Act Release No. 11604 (Aug. 19, 1975), 40 FR 40509 (Sept. 3, 1975).

[5] 17 CFR 249.819b.